

# New Jersey Economic Review & Outlook For 2005-2006

**Forecast Summary “New Jersey’s economy has outperformed the national economy for six straight years and is likely to keep that streak alive in 2005.”**

*Dr. Joseph J. Seneca, Chairman*      **February 2005**

## New Jersey Forecast 2005 –2006



The New Jersey economy had a breakout year in 2004 after struggling for three years in the context of a weak national economy. Indeed, as detailed later in this review, New Jersey’s economy was one of the best performing in the nation. Employment increased by 75,900 jobs, or by 1.9%, from December 2003 through December 2004. This strong performance stands in sharp contrast to the state’s meager 0.6% increase in 2003 and job declines of -0.4% and -0.8% in the two previous years. With almost all of the state’s employment sectors showing gains in the last year, New Jersey has strong economic momentum going into 2005.

Summary: New Jersey Forecast (% Change)		
	<u>2005</u>	<u>2006</u>
Gross State Product (Current \$, bill)	4.6%	4.3%
Personal Income (Current \$, bill)	4.7%	3.5%
Retail Sales (Current \$, bill)	4.1%	3.2%
Consumer Price Index (All Urban)	3.2%	2.7%
Total Non-Ag Employment	1.4%	1.1%

The outlook for 2005 is for continued, but moderating, growth. The state’s export and transportation and warehousing sectors will benefit from the decline in the dollar as the volume of international trade expands. Solid increases in national capital spending on computer equipment and software will assist the state’s long-suffering technology sector. Leisure and tourism will benefit from steady gains in income and employment. Pharmaceuticals and biotechnology, supported by long-term demographic trends of a large and now

aging baby boom generation, remains a cornerstone of New Jersey’s high technology economy. But relentless competition, legal problems, and possible changes in federal regulatory oversight will keep cost pressures on the industry.

New Jersey’s red-hot residential construction and existing home markets will cool as rising mortgage rates and constraints on building sites reduce both demand and supply. High vacancy rates for office space, despite record levels of employment in New Jersey, will reduce commercial construction’s contribution to growth in 2005.

Consumers will continue to do the heavy economic lifting in 2005 supported by gains in employment and income. However, high levels of consumer debt, the end of federal income tax cuts, and significantly higher energy costs since last year will constrain increases in consumer spending.

A high federal deficit and a second term administration in Washington with a focus on tighter spending controls dampens the prospect for any boost for the state from the federal budget. The state’s high technology sector, which has benefited from federal defense and homeland security spending, will be hard pressed to receive the same level of federal spending in 2005 as last year.

Manufacturing showed signs of stabilizing in 2004 as the employment decline in this long-battered sector moderated. However, the sector remains under intense pressure from lower cost competitors across the country and the globe.

The end of federal depreciation tax incentives for investment spending is another factor contributing to slower growth in 2005. Continuing improvements in the New York City economy after another good year in the capital markets, and from accelerating employment growth in Pennsylvania, will help regional economic activity.



## The U.S. Economy

The national economy (finally!) roared to life in 2004 with strong gains in *both* real Gross Domestic Product (4.4%) and in employment (1.7%) for the first time since 2000. Growth was led by consumer spending (3.8%), residential investment (9.5%), business capital spending (13.4%), and exports (8.1%). Import growth (9.8%) and weak state and local government spending (0.4%) constrained GDP growth. Employment increases averaged 186,000 new jobs per month and, as a result, the unemployment rate drifted down to 5.4% by year's end. Total personal income rose by a robust 5.3% and the equity markets had a respectable year with the Standard and Poors 500 rising by nearly 9%. Inflation, rather than deflation, emerged as a concern as energy prices spiked and commodity prices rose in response to global demand pressures and the Consumer Price Index increased by 3.3%.

The national economy should slow in 2005 from the strong, above trend, 4.4% increase in GDP of last year as higher energy prices, rising interest rates, and the end of the federal tax cut stimulus dampen consumer spending. The red-hot housing sector, which has sustained the recovery to date, is unlikely to contribute to growth in 2005. Federal spending, after rising by 7.5% in 2002, 6.6% in 2003, and 4.7% last year, is also likely to contribute less to growth in the year ahead.

Business spending on technology should remain a positive factor since firms have large cash balances and are likely to continue to invest in technology upgrades. Exports will boost the economy again in 2005 as the dollar continues to depreciate and import growth should moderate. Given the improving economy, monetary policy will turn less accommodative as the Federal Reserve continues on its path of restoring interest rates to more historically comparable levels, as well as reducing the rate of increase in the money supply.

Payroll employment will add 2 million new jobs in 2005, a decline from the past year's pace, but still sufficient to absorb new entrants into the labor force, nudge the unemployment rate lower, and support income growth. The extraordinary increases in productivity over the last several years are now history and any growth in output must increasingly be met by new hiring. Inflation, always at the mercy of energy costs, should remain in the 3% range as increases in commodity prices and import prices, and some increased testing of pricing power by businesses contribute to general price increases.

Factors that could upset this outlook for moderating but steady growth are further energy cost spikes, terrorism, and a free-fall in the dollar. These all could result in sharp increases in interest rates and disrupt capital markets, housing, and consumer spending.



## New Jersey Ranks Among the Leaders

In the past year, the national economic recovery finally took hold across the country. As of December 2004, unemployment rates had declined in 43 states compared to the previous December. Employment levels increased in 48 of the 50 states and did so in almost every sector.

### Annual Employment Change by State December 2003 - December 2004 Seasonally Adjusted, in thousands

State	Change: Dec.03-Dec.04	Rank
Florida	172.3	1
California	152.3	2
Texas	124.8	3
Virginia	79.5	4
North Carolina	76.4	5
<b>New Jersey</b>	<b>75.9</b>	<b>6</b>
Pennsylvania	70.5	7
Washington	64.5	8
Arizona	63.9	9
Wisconsin	63.6	10

Within the broad national recovery in 2004, New Jersey stands out. Employment in New Jersey grew by 75,900 from December 2003 to December

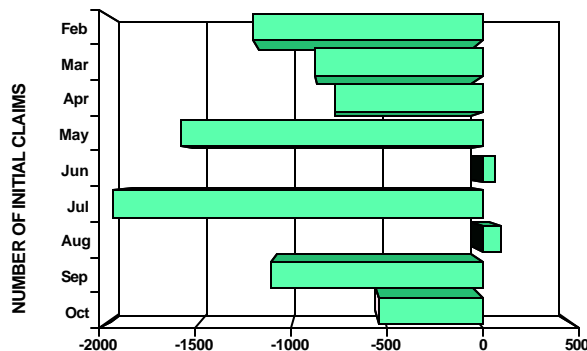
2004 and the state ranked 6<sup>th</sup> among all states in job gains. Only the Sunbelt and southern states of Florida, California, Texas, Virginia, and North Carolina did better. New Jersey ranked ahead of all our neighbors (Pennsylvania +70,500 jobs, New York +58,500 jobs, and Connecticut +8,000 jobs). New Jersey also did well in terms of private sector job creation, ranking 10<sup>th</sup> with 58,800 new jobs.

## Employment Profile



By the end of 2004 New Jersey's unemployment rate (4.2% as of December) was more than a full percentage point below that of the nation and the state's job gains were broad based. Another sign of improvement in the state's labor markets was the decline in initial unemployment claims in 2004 compared to a year ago.

### Initial Claims for NJ Unemployment Insurance, Change from Year Ago



By April of 2004 New Jersey's total employment surpassed its previous peak set in December 2000 and continued to establish new records every month since. By year's end (December 2004), employment in New Jersey was 4,075,100, or 49,800 jobs higher than the previous peak. New Jersey had regained 174% of the 67,000 jobs lost during the 27-month employment decline from December 2000 to March 2003.

Overall in 2004, employment increased by 75,900 jobs, significantly above the long-term post World War II annual average of 50,000. The job gains were broad based with strong increases in

education and health services (15,200), leisure and hospitality (12,500), professional and business services (10,400), finance (9,600), construction (8,200), and government (17,100). Only two sectors lost jobs. On-going instability in wired telecommunications caused employment in the information sector to decline (-700). Manufacturing continued its long run employment decline (-4,600), although the rate of loss slowed considerably from last year (-10,400).

### NJ Employment % Change by Sectors, 2003-04

Sectors	Percent
Construction	5.2%
Leisure and Hospitality	3.9%
Financial Activities	3.4%
Educational and Health Services	2.8%
Government	2.7%
Professional & Business Services	1.8%
Trade, Transportation, and Utilities	0.6%
Information	-0.7%
Manufacturing	-1.3%
Total Non-Ag	1.9%

In previous Outlooks, the Council identified six business clusters that embody dynamic aspects of the New Jersey economy. Together these six clusters contain over 25% of total private sector employment in New Jersey. In 2004, employment grew in four of the six clusters, a distinct turnaround from the previous year when employment declined in four of the six clusters.

### Employment in NJ Growth Clusters, Change 2003-04

	Number (000)	Percent
Finance	2.2	1.6%
Science and Technology	0.3	0.2%
Casino/Entertainment	0.3	0.3%
Pharmaceutical/Bio Tech	0.2	0.3%
Logistics	-1.4	-0.5%
Information Technology	-2.2	-1.7%
Cluster Total	-0.5	-0.10%

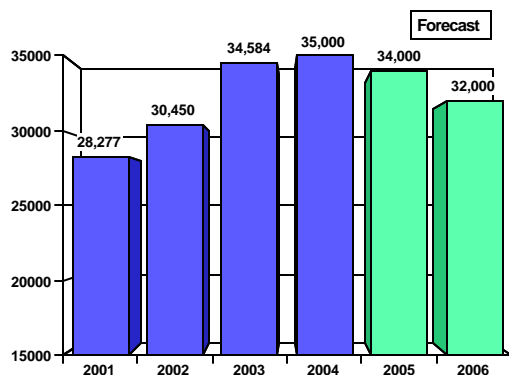
## Personal Income and Consumer Spending

Total personal income grew by 4.2% in 2004 (3<sup>rd</sup> quarter 04 vs. 3<sup>rd</sup> quarter 03). Income was boosted by the state's strong employment gains and by federal tax cuts. Continuing increases in employment and increases in interest and dividend income will support income growth in 2005. Personal income is projected to rise by 4.7%.

Consumer spending faces a mixed outlook for 2005. The boost in disposable income from the federal tax cuts is now past. Rising interest rates, higher energy prices, and increases in health care costs will dampen spending. Home equity loans, which have been heavily used by households to finance spending, are likely to decline as interest rates rise. However, solid employment gains will continue to assist income and spending. As a result, consumer spending is expected to increase by 4.7% in 2005.

New residential building permits in 2004 exceeded 30,000 units for the third consecutive year. Sales of existing homes were up 7% over the already high levels of 2003. Spending on home improvements was very strong and supported large gains in retail sales for furnishings and in construction employment. Total construction employment (167,000) is near its all-time high.

**NJ Residential Building Permits, No.**



New vehicle registrations weakened in 2004 despite a series of dealer incentive offers throughout the year. Through November 2004, new registrations totaled 590,218 and were 2.9% below the comparable period a year ago. However, the level of new

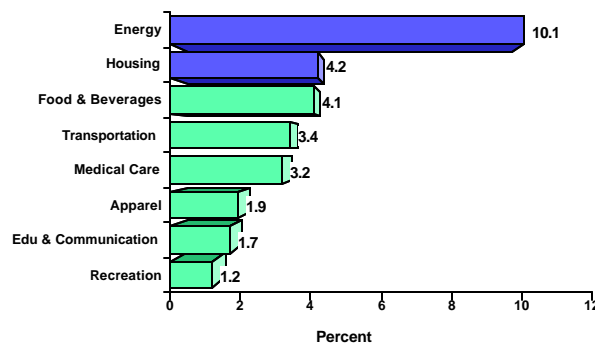
registrations remains high and the outlook is for new registrations to again exceed 600,000 in 2005.

## Consumer Prices



Inflation, which had been dormant for many years, stirred in 2004 and prices in the New York/New Jersey metropolitan area rose by 3.5%, an acceleration from last year's pace of 3.1%. Energy price spikes in early spring and again in late summer dominated the increase (10.1%) and drained consumer spending on other goods and services (see Sidebar). Transportation costs (3.4%), food costs (4.1%), and housing costs (4.2%) also contributed to the higher inflation rate. Below average increases occurred in medical care (3.2%), apparel (1.9%), and education and communication (1.7%).

**NY/NJ Consumer Price Index, by Expenditure Category, % Change 2003-04**  
All Items = 3.5 %



There was a surge in commodity and producer prices nationally, but these increases have only partly penetrated into the prices of final products. The decline in the dollar will continue to put upward pressures on the prices of imports. Businesses, which previously lacked pricing power due to global competition and excess capacity, may begin to explore edging prices upward. The main unknown, as always, is energy costs. Forecasts call for a stabilization and subsequent decline in energy costs this year (but that was also the consensus projection for 2004!). Accordingly, caution should prevail concerning the forecast, which calls for inflation to moderate slightly in 2005.

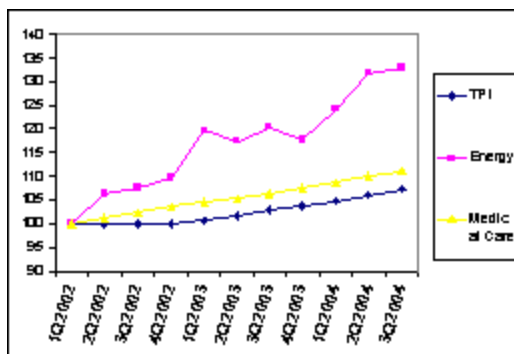


### Energy and Medical Care Costs

The drain on consumer spending from increased energy and medical care costs has been considerable. The on-going uncertain nature of energy supplies raises the possibility of further oil price spikes given the volatility in prices that occurred in 2004. A barrel of oil increased in price from \$33 in January 2004 to a peak of \$55 in October 04. It has fallen back to the \$45 range recently. At the national level, every \$10 increase in the price of oil represents the equivalent of about a \$70 billion tax on consumers as expenditures on other goods and services are diverted to pay for higher energy costs.

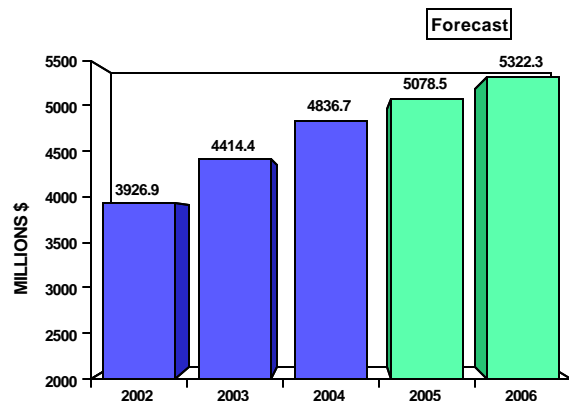
Final energy use makes up an estimated 7% of the Consumer Price Index in terms of its relative importance among all goods and services purchased by consumers. Medical care costs represent another 6%. The chart below provides a perspective on the change in the national costs of both final energy use and medical care compared to the increase in total personal income in New Jersey. From the first quarter of 2002 until the third quarter of 2004, total personal income in New Jersey increased by 7.2% as the state emerged from the national recession and began to recover jobs and economic activity. Energy costs, however, have increased by 33% over the same time while medical care costs have gone up by 11%. Because the demand for both energy and medical care is not very sensitive to price, particularly in the short run, these two components of consumer spending have diverted significant amounts of consumer spending from other goods and services. At the level of the national economy, this drag on consumer spending was responsible for the slowdown in the economy after the big oil price spike in the spring when the growth in consumer expenditures fell from a 4.1% pace in the first quarter to 1.6 % increase in the second quarter.

**Indices: New Jersey Total Personal Income vs. CPI-Energy and CPI-Medical Care**  
1st Quarter 2002 - 3rd Quarter 2004  
(2002.1 = 100.0)



Residential construction had another good year in 2004 supported by low mortgage rates and growth in incomes. Through the first ten months of 2004, permits are up 6% over 2003, and should approach 35,000 for the entire year. Home prices continue to soar. The price of an existing single-family home in New Jersey rose by 12%. The value of residential construction contracts increased by 9.6 % in 2004 as a result of the increase in housing activity and the continued trend toward larger homes. Constraints on the supply of building sites and the effects of rising mortgage rates will slow new building activity in 2005. The increase in the value of construction contracts should moderate to 5%.

**NJ Residential Construction Contracts, \$**



Non-residential construction in New Jersey continues to be affected by rising vacancy rates for commercial space. In the 3<sup>rd</sup> quarter of 2004, the vacancy rate for Class A space in the 10 county Northern and Central New Jersey was 27%, up from 21.6% in the second quarter. Despite strong job growth and the fact that the total number of jobs in New Jersey now exceeds the previous peak, about 12% less office space is being utilized as businesses have imposed more cost discipline. Non-residential construction contracts declined in 2004 (through November) by 14% from the comparable period in 2003.

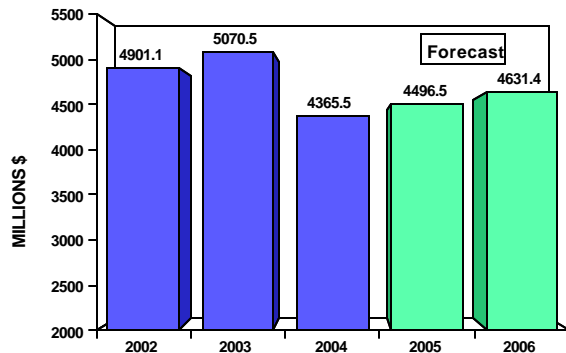
There has been continued strength in education building as a result of the NJ school construction program and this has supported non-residential contracts. As job growth continues and





the housing market cools, activity in non-residential construction should improve over the next several years.

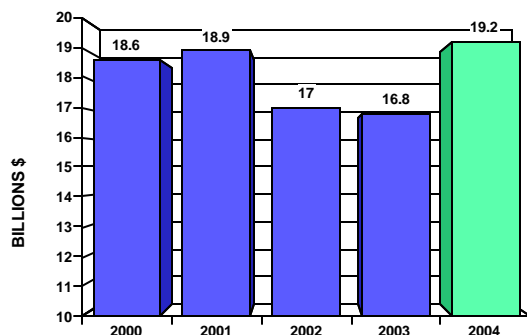
### NJ Non-Residential Construction Contracts, \$



### International Trade

International trade was the surprise sector for the state in 2004. New Jersey's exports increased by a strong 14.7% (through the 3<sup>rd</sup> quarter) as the depreciation of the dollar began to significantly improve the competitiveness of U.S. goods and services. U.S. exports rose by 13.8% in the same period. The state's largest export destinations are Canada, the United Kingdom, Germany, Israel, Japan, and Mexico. Exports totaled \$14.2 billion through the 3<sup>rd</sup> quarter and the major categories of exported goods were chemicals, computers and electronic products, transportation equipment, and machinery. In addition, the large increase in the volume of both exports and imports in the region's port areas benefited the transportation, logistics, and warehouse activity in New Jersey. With further declines in the dollar expected in 2005, exports should continue to support economic growth in the state.

### New Jersey Exports, in \$ Billions



### The Region

The recovery of the region continued in 2004 with New York City finally adding jobs after several difficult years following the attacks of September 11<sup>th</sup> 2001. For 2004 (through November), employment increased by 31,100 jobs, still leaving the City 205,700 jobs below its December 2000 level. Nevertheless, 2004 was the first year since 2000 when jobs actually increased. The largest job gains occurred in professional services, hospitality, and retail trade. The weaker dollar has given tourism a significant boost and the number of foreign visitors to New York rose by a robust 10.2% in 2004, but is still about 22% below its 2000 level. Hotel occupancy, ridership on the subways, bridge and tunnel crossings, and port traffic are all up and commercial vacancy rates have fallen.

One important sector that has not added jobs is finance, the most visible and economically powerful part of the City's economy. Despite strong gains in the capital markets in the last two years, employment in the financial industry in New York City has essentially been flat since August 2003. Financial jobs were moved out of the City after the attacks of 9/11. In addition, technological innovations and outsourcing have eliminated and dispersed many lower paying financial sector jobs since then. This trend is likely to continue. The financial jobs that remain in the City are well paying and salary bonuses for the sector in 2004 are estimated at \$15.9 billion. These bonuses will provide strong support for consumer and housing expenditures in the region.

New Jersey has been the partial beneficiary of the dispersal of financial jobs from New York City. Since September 2001, employment in financial activities in New Jersey has increased by 21,700 and is now at an all-time high of nearly 288,000 jobs. Due to the destruction and disruption caused by the terrorist attacks in the immediate months after 9/11, New Jersey received over 14,000 jobs as New York firms relocated offices and people in order to continue operations. About 5,000 of these jobs returned to New York City in the first half of 2002, but job growth in the finance sector in New Jersey resumed by July 2002 and has increased steadily since. Further improvement in the overall New York City economy is anticipated in 2005 and this will support economic activity in the region.

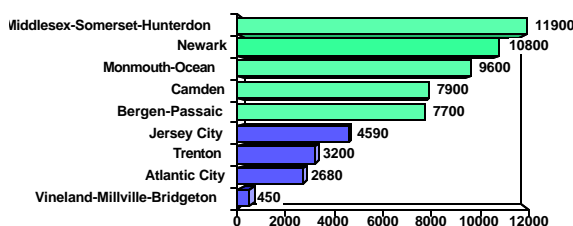


Economic conditions in Philadelphia stabilized in 2004. Employment in the private sector increased by 1,700 jobs after falling by 4,500 jobs a year earlier. Last year, educational and health services added a strong 7,700 jobs, but jobs declined in manufacturing, trade, and finance. The outlook is for improving labor market conditions in Philadelphia with accompanying gains in income and consumer spending that will benefit the region.

## New Jersey Labor Markets

The strong employment gains for the state in 2004 were reflected in all the state's labor market areas. The Middlesex-Somerset-Hunterdon labor market area added 11,900 jobs, the largest increase of all the state's labor market areas. The Monmouth-Ocean labor market was the fastest growing area (2.4%, or 9,600 jobs). Strong absolute gains also occurred in Newark (10,800 jobs), Camden (7,900 jobs), and Bergen-Passaic (7,700). New Jersey labor markets will be redefined in 2005 following changes based on commuting and population patterns from the U.S. Census of 2000.

### New Jersey Labor Market Non-Ag Payroll Employment Change, 2003-04 (In Thousands)



## Summary

Over the last six years, through good times and bad, New Jersey's economy has outperformed the national economy. We are likely to see that streak continue in 2005. However, it is vital that public policy ensure that New Jersey remains an attractive place for individuals and businesses to locate and invest.

### NJ COUNCIL OF ECONOMIC ADVISORS

About the Council of Economic Advisors:  
Established by law in 1993 (P.L. 1993, Chapter 149).

The Council is an advisory organization reporting directly and independently to the Executive branch of government, the Legislature and the public.

The Council is charged with the preparation of an Annual Report and a mid-year Report analyzing current New Jersey economic conditions and forecasting future developments, assists the Executive in preparation of the annual budget message, and advises the Governor and Legislature on public policies impacting the State's economy.

The Council is comprised of a Chairman appointed by the Governor and legislative appointees.

#### The Council members are:

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## New Jersey Economic Outlook & Review For 2005-06

<i>(Current \$ or Nos.)</i>	NJCEA Forecast					
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Gross State Product (bill \$)	362.9	380.2	397.5	416.6	435.7	454.5
Personal Income (bill \$) <sup>1</sup>	332.7	337.9	345.6	363.5	380.6	393.9
Retail Sales (bill \$)	105.0	106.7	109.4	114.3	119.0	122.8
New Vehicle Registrations (000) <sup>2</sup>	655.5	646.4	659.1	643.9	640.7	642.6
Non-Res. Construction Contracts (mill \$) <sup>3</sup>	5,017.6	4,901.1	5,070.5	4,365.5	4,496.5	4,631.4
Residential Building Permits (No.)	28,277	30,450	34,584	35,000	34,000	32,000
Res. Construction Contracts (mill \$) <sup>4</sup>	3,885.7	3,926.9	4,414.4	4,836.7	5,078.5	5,322.3
CPI (1982-1984=100)	187.1	191.9	197.8	204.8	211.4	217.2
<i>(Real 1982\$)</i>						
Gross State Product (bill \$)	193.9	198.1	200.9	203.4	206.1	209.2
Personal Income (bill \$)	177.8	176.1	174.7	177.5	180.0	181.4
Retail Sales (bill \$)	56.1	55.6	55.3	55.8	56.3	56.5
<i>Employment</i> <sup>5</sup>						
Total Nonfarm (000)	3,997.2	3,983.9	3,980.3	4,039.8	4,096.4	4,141.5
Manufacturing (000)	401.2	367.5	351.7	345.6	345.6	345.6
Private Service-Providing (000)	2,832.8	2,838.8	2,843.4	2,888.1	2,943.0	2,990.1
Government (000)	602.6	613.5	624.3	640.9	650.5	660.3
Unemployment Rate (%)	4.2	5.8	5.9	4.9	4.6	4.4
<b>Percentage Change from previous year:</b>						
		<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
<i>(Current \$ or Nos.)</i>						
Gross State Product		4.8	4.6	4.8	4.6	4.3
Personal Income <sup>1</sup>		1.5	2.3	5.2	4.7	3.5
Retail Sales		1.6	2.5	4.5	4.1	3.2
New Vehicle Registrations		-1.4	2.0	-2.3	-0.5	0.3
Non-Res. Construction Contracts		-2.3	3.5	-13.9	3.0	3.0
Residential Building Permits		7.7	13.6	1.2	-2.9	-5.9
Res. Construction Contracts		1.1	12.4	9.6	5.0	4.8
CPI (1982-1984=100)		2.6	3.1	3.5	3.2	2.7
<i>(Real 1982\$)</i>						
Gross State Product		2.1	1.4	1.2	1.3	1.5
Personal Income		-1.0	-0.8	1.6	1.4	0.7
Retail Sales		-0.9	-0.5	0.9	0.9	0.4
<i>Employment</i>						
Total Nonfarm		-0.3	-0.1	1.5	1.4	1.1
Manufacturing		-8.4	-4.3	-1.7	0.0	0.0
Private Service-Providing		0.2	0.2	1.6	1.9	1.6
Government		1.8	1.8	2.7	1.5	1.5

1. The estimated 5.2% increase in personal Income for 2004 is based on the increase of the average of the first three quarters of 2004 over the first three quarters of 2003.

2. The 2004 total for New Vehicle Registrations was computed as the sum of registrations reported for the months January-November, plus a December estimate calculated as the average of the January through November totals.

3. The 2004 total value for Non-Residential Construction Contracts was computed as the sum of the totals reported for the months January-November, plus a December estimate calculated as the average of the January through November totals.

4. The 2004 total value for Residential Construction Contracts was computed as the sum of the totals reported for the months January-November, plus a December estimate calculated as the average of the January through November totals.

5. Employment figures for 2001-2004 are based on non-seasonally adjusted 12-month averages.